

Germany and Austria Release Guidance on New Size-of-Transaction Test in Merger Control

Final joint guidance on new transaction value threshold published.

The German Federal Cartel Office (FCO) and the Austrian Federal Competition Authority (FCA) have released a joint guidance paper (Guidance Paper) clarifying the application of their respective new thresholds for transactions. The release of the Guidance Paper on July 9, 2018 follows recent amendments to German and Austrian law. The 9th amendment to the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, or GWB) and the Austrian Cartel and Competition Law Amendment Act 2017 (*Kartellgesetz*, or KartG), which became effective in June and April 2017, respectively, both introduced new provisions on merger control jurisdiction on the basis of a “size-of-transaction” test.

Key changes

The new thresholds supplement existing filing thresholds with an alternative size-of-transaction test. The new thresholds capture transactions for which the value of consideration exceeds €200 million, in the case of Austria, or €400 million, in the case of Germany — even if the target has minimal or no revenue in the respective jurisdictions. The new thresholds are based on the assumption that in such situations, the target’s revenues do not (yet) reflect the target’s true market potential.

The practical application of these new thresholds raises questions about:

- The methodology for calculating the “value of consideration”
- How to determine whether the transaction has the requisite local nexus to Germany or Austria, even in the absence of material turnover by the target in these jurisdictions

While the Guidance Paper explains both concepts and also provides practical examples, the local nexus requirement in particular remains an ill-defined concept.

Value of the consideration

The Guidance Paper defines the value of consideration as “all assets and other monetary benefits that the seller receives from the buyer in connection with the merger in question.” The term “asset” must be interpreted broadly to include all cash payments, the transfer of voting rights, securities, as well as tangible and intangible assets. The value of consideration also includes payments that are contingent on

certain conditions, such as those specified in earn-out clauses, or agreed additional payments to the seller. These terms depend on the achievement of certain turnover or profit targets at a specific point in the future (e.g., license fees), as well as liabilities assumed by the buyer or payments for non-competition by the seller.

The reference date for determining the value of consideration is the time of closing. This may lead to practical difficulties in which the transaction value may fluctuate between signing and closing (e.g., if consideration consists of listed securities). Similarly, future payments must be discounted by calculating net present value at the anticipated time of closing. In these borderline situations, the safest course of action may be to make precautionary notifications.

Local nexus

To exclude transactions that have no local nexus, the new thresholds only apply if the target company has “substantial domestic operations” in Germany or Austria.

Domestic operation

A domestic operation requires a market-facing *activity* of the target company. Such activity is generally not measured on the basis of domestic turnover, even though turnover could be used as a criterion in mature markets. In particular, in two-sided markets (such as advertising-supported online services), domestic activity can be measured by metrics such as “monthly active users.”

The Guidance Paper clarifies that research and development (R&D) activity in the respective jurisdictions can also constitute a relevant domestic activity. A local nexus should be assumed if the R&D results are capable of being marketed domestically. This is not the case if the relevant R&D concerns foundational technology or early-stage development of medicines, pharmaceutical devices, or crop protection, as opposed to application research or Phase III clinical trials.

In Austria, the target’s location can also be a reference point for domestic activity (e.g., if the target company has a production facility located in Austria, even if the target’s customers are outside of Austria). However, the mere location of a holding company (without market-facing activity) in Austria does not constitute a sufficient nexus to Austria. The existence of a local presence is less relevant for the German threshold.

A domestic activity must also have *market orientation*, which exists when the target company provides a service against payment on an existing market. In the absence of monetization, an activity can still have market orientation if any of the following apply:

- A service is remunerated by means other than monetary payment (e.g., by supplying data or consuming advertising)
- A service is currently offered free of charge, but it can be expected to require payment (or be monetized in a different way) in the future
- The activity consists of R&D for (future) products or services (in which case, the determining factor is whether the research results will be marketable; whether turnover has already been generated or the product has been launched already is irrelevant)

Significance of domestic activities

The target's domestic activity must also be "significant" in order to be captured by the new thresholds.

- For Germany, domestic turnover below €5 million (a threshold above which a filing will typically be required in any event, even without the new size-of-transaction thresholds) is deemed *not* to be significant for products that have already been on the market for some time (even if primarily outside of Germany). For newly introduced products or services on two-sided markets, the Guidance Paper remains rather vague. However, it does state, by way of example, that apps with more than one million monthly active users in Germany (70,000 in the case of Austria) would normally constitute "significant" domestic activity.
- For Austria, in the case of products that have been on the market for some time, the FCA will deem domestic activity insignificant if the target generates turnover in Austria below €500,000. This is noteworthy given that independently of the new value-of-transaction threshold, the Austrian merger control system requires notification even if the target has no domestic revenues, provided that the acquirer meets certain revenue thresholds in Austria. It remains to be seen if the "soft" €500,000 threshold in the Guidance Paper will have any impact on the Austrian Authority's merger practice more generally, in terms of requiring minimal local nexus.

Conclusion

The Guidance Paper provides helpful direction about how to determine the value of consideration and local nexus, but at the same time illustrates some of the conceptual and practical difficulties in applying the new thresholds. The Guidance Paper also illustrates that the German and Austrian authorities may take different views on the same set of facts. Pre-notification contacts and, if necessary, precautionary notifications may thus be advisable until a more solid body of precedent is established.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Sven B. Völcker

sven.voelcker@lw.com
+32.2.788.6242
Brussels

Jana K. Dammann de Chaptó

jana.dammann@lw.com
+49.40.4140.3413
Hamburg

Immo Schuler

immo.schuler@lw.com
+49.69.6062.6609
Frankfurt

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